

Record Corporate Profits at Time of Crisis Show the 'Falling Rate of Profit' Theory of Crises is False

This is a slightly revised letter I sent out to friends on Nov. 28, 2010 together with an article from the New York Times pointing out that corporate profits were at record highs. My comments led to a question from a friend about Marx's 'falling rate of profit' theory of capitalist economic crises, which I then responded to. –S.H.]

Date: Sun, 28 Nov 2010 23:17:18 +0000

Subject: Record high U.S. corporate profits and crisis theory

Hi everybody,

In case you missed it, appended below is a recent *NYTimes* article about the current huge corporate profits in the U.S. Note that they are at a record high for the recent quarter in nominal terms, though not quite a record in inflation-adjusted terms (though they are still close to record highs even then.)

At some point I hope to get around to more thoroughly critiquing the theory that *the falling rate of profit* explains overproduction crises. However, for now, note that empirically this theory doesn't make a lot of sense. Corporate profits were extremely high in 2006 *before* the recent bout of financial crisis hit, took only a short-term sharp dip *after* that financial crisis began, and are extremely high now in the wake of the financial panic of 2008-9—even though the economic crisis as a whole still continues almost unabated.

Marx presented 3 main crisis theories in *Capital*:

- The oldest and most basic of them, which goes back to the *Communist Manifesto*, but which is also the most prominent theory in *Capital*, is the **overproduction of capital theory** (based on the fact that overproduction is inherent in the capitalist system which depends on the extraction of surplus value). This is called the *underconsumption theory* by its opponents. In my own view this is the most essentially correct theory, and the only real theory of crises that we need.
- The **anarchy of production theory** that in effect says capitalist crises are due to the lack of economic planning. There is only some limited secondary validity to this theory, in my view. This is the theory adopted by the RCP in *AID*, and also by most Marxists who have been more influenced by Lenin's economic writings in the late 1890s than they have been by Marx's economic writings. Hilferding also pushed this theory in his very influential 1910 book *Finance Capital*. This theory is particular popular among those who view nationalization as the essence of socialism, and those who (like Hilferding) argue that more state planning *even under capitalism* can prevent crises. (I.e., the theory of "organized capitalism".)
- The **falling rate of profit theory**, which says that crises are due to the rise in the organic composition of capital (the use of ever more machinery relative to human labor), and

which therefore must result in the long-term fall in profits because only human labor can produce surplus value (the source of profits). Marx has several chapters in vol. III of *Capital* that push this theory, though most of the rest of the work supports the overproduction of capital theory. Empirically, this theory has been pretty much demonstrated to be incorrect, and even more so with the current crisis than in earlier crises (though there have been some efforts by a couple Trotskyist writers on economics to explain away the evidence). There are a lot of theoretical problems with this theory too, and even Marx talked about many of the countervailing forces in connection with it.

I have one particular theoretical argument against the falling rate of profit theory that very few (if any!) other Marxists agree with me about, but if it is accepted it is devastating for the falling rate of profits theory (even without considering the other arguments against it). I agree with Marx that only human labor (at least so far on the planet Earth) can generate surplus value. But unlike Marx, I view machinery itself as a means of *reusing* past human labor. (See some of my comments on this at <http://www.massline.org/PolitEcon/index.htm> in the Labor Theory of Value section.) This means that machinery can also contribute to the generation of surplus value, and that profits need *not* decline as more machinery is used; indeed, they may very well *increase!* Of course this modification of the LTV is a very big (and potentially very controversial) topic in itself.

But, regardless of all theoretical considerations, it seems to me that empirically the theory that the falling rate of profit can be the cause of capitalist economic crises is once again shown to be false.

It is certainly true that profits do fall at times during crises, especially as markets dry up for other reasons—unless these profits are made up in other ways—such as through financial thievery on a massive scale. All crisis theories recognize that profits can fall, but it is a question of which is cause and which is effect.

In the future (at least over the medium and long-term) I predict that profits will indeed fall in a major way as the economic crisis continues to develop. But the fact that profits were high before the latest severe stage of the crisis, and even now well into the crisis, sure seems to me to prove that falling profits are not the *cause* of the crisis.

Scott

From:

<http://www.nytimes.com/2010/11/24/business/economy/24econ.html?sq=commerce%20department%20profits&st=Search&adxnnl=1&scp=1&adxnnlx=1290794401-PNA2asdntRHrotq8QDeIBA>

The New York Times

November 23, 2010

Corporate Profits Were the Highest on Record Last Quarter

By CATHERINE RAMPELL

The nation's workers may be struggling, but American companies just had their best quarter ever.

American businesses earned profits at an annual rate of \$1.659 trillion in the third quarter, [according to a Commerce Department report](#) released Tuesday. That is the highest figure recorded since the government began keeping track over 60 years ago, at least in nominal or noninflation-adjusted terms.

The government does not adjust the numbers for inflation, in part because these corporate profits can be affected by pricing changes from all over the world and because the government does not have a price index for individual companies. The next-highest annual corporate profits level on record was in the third quarter of 2006, when they were \$1.655 trillion.

Corporate profits have been doing extremely well for a while. Since their cyclical low in the fourth quarter of 2008, profits have grown for seven consecutive quarters, at some of the fastest rates in history. As a share of gross domestic product, corporate profits also have been increasing, and they now represent 11.2 percent of total output. That is the highest share since the fourth quarter of 2006, when they accounted for 11.7 percent of output.

This breakneck pace can be partly attributed to strong productivity growth — which means companies have been able to make more with less — as well as the fact that some of the profits of American companies come from abroad. Economic conditions in the United States may still be sluggish, but many emerging markets like India and China are expanding rapidly.

Tuesday's Commerce Department report also showed that the nation's output grew at a slightly faster pace than originally estimated last quarter. Its growth rate, of 2.5 percent a year in inflation-adjusted terms, is higher than the initial estimate of 2 percent. The economy grew at a 1.7 percent annual rate in the second quarter.

Still, most economists say the current growth rate is far too slow to recover the considerable ground lost during the [recession](#).

"The economy is not growing fast enough to reduce significantly the unemployment rate or to prevent a slide into [deflation](#)," Paul Dales, a United States economist for Capital Economics, wrote in a note to clients. "This is unlikely to change in 2011 or 2012."

The increase in output in the third quarter was driven primarily by stronger consumer spending. Wages and salaries also rose in the third quarter, which might help bolster holiday spending in the final months of 2010.

Private inventory investment, nonresidential fixed investment, exports and federal government also contributed to higher output. These sources of growth were partly offset by a rise in imports.

----- Original Message -----

Sent: Sunday, November 28, 2010

Subject: RE: Record high U.S. corporate profits and crisis theory

Hi,

It has been my understanding that Marx' analysis was not about some absolute falling rate of profit, but about "the tendency of the rate of profit to fall" indicating a general direction related to the change in the organic composition of capital--not a rule that operates unaffected by all other factors. I haven't had a chance to refresh my understanding of this, or research it further. So my question is, wasn't the theory about the tendency, and not a consistent, ever-present linear pathway?

doug

Sent: Monday, November 29, 2010

Hi Doug,

The short answer is... yes! However, here's a much longer answer, as well:

First, with regard to whether it is appropriate to call any "tendency", even if it does actually exist, a "law": Marx calls it both: "The law of the tendency of the rate of profit to fall" is the title he gives to Part III of volume III of *Capital*. However, science has (at least since then, if not already by Marx's time) decided that tendencies should not be called "laws". Scientific laws are now considered to be (or defined to be) statements (about some aspect of nature, human beings or society) which are *always* found to be true, at least under the stated or implied conditions. When it is determined that some scientific law is *not* true under certain conditions, then the law is reformulated to exclude those conditions. If this cannot be done, it is no longer called a law at all.

This is the nearly universal view in the physical sciences. For example, in their recent book, *The Grand Design*, Stephen Hawking & Leonard Mlodinow say:

"In modern science laws of nature are usually phrased in mathematics. They can be either exact or approximate, but they must have been observed to hold without exception—if not universally, then at least under a stipulated set of conditions."
[p. 28. Although Hawking & Mlodinow are philosophical idealists in many important respects, they are correct about how the phrase "scientific law" is used in the physical sciences, at least.]

However, in contemporary bourgeois social science, including economics, this is probably not the dominant view. If no exceptions were allowed, and mere proclaimed tendencies were excluded, there would be extremely few *if any* scientific laws in bourgeois social science. (And it

is much harder to refute claims about "tendencies".) Moreover the sort of thing that they usually *call* a law, such as "[Say's Law](#)", a fundamental assumption of bourgeois political economy that capitalist production creates its own full market demand, is in fact totally fallacious. Because bourgeois social science has essentially no real scientific laws to point to they tend to use the phrase in a much looser manner, when they use it at all.

Alas, this circumstance has also infected contemporary revolutionary Marxism. In my critique of the RCP's *Notes on Political Economy* (<http://www.massline.org/PolitEcon/ScottH/NotesNPE.htm>), I have a whole section called "Tendencies and Tendency Laws" devoted to criticizing them on this point.

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The next issue is whether Marx claimed that the tendency of the rate of profit to fall is "uniform" or "linear" (always falling at the same rate), or even whether it is what mathematicians call "monotonic" (always headed in the same direction, up or down, even if there are changes in the rate of increase or decrease). I think it is clear that Marx was talking only about a *general* tendency for profits to fall, and thus not at all excluding the possibility that within this overall downward direction there might be some secondary ups and downs, as well as changes in the rate of fall or temporary rise.

This means that if there are some fairly short or shallow periods of increasing profits, these by themselves will in no way show that Marx was wrong about what he called his "law of the tendency of profits to fall".

On the other hand, this does not mean that Marx's proposed law here is unfalsifiable, or that *nothing* can show that it is in error. Short and shallow increases in profits, or even a few large but brief spikes upward will not show Marx to be wrong. But his claim is that *overall*, and *in general*, and *over the long run* profits should fall. If this does *not* happen, then Marx is wrong about this "law" or tendency (whichever we want to call it). And, in fact, the empirical evidence has shown pretty clearly that he is wrong about this.

If Marx is viewed as *not* claiming that there is an overall, general, or long-term tendency for the rate of profit to fall, then what could it be imagined that he *is* claiming? What would be the point of this "law of the tendency of the rate of profit to fall" at all? If it is presumed to be saying nothing about the overall situation, or nothing about *either* the short term or the long term, or nothing about *either* the immediate situation or the general situation, then the "law" becomes completely vacuous and meaningless.

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One of the things that used to puzzle me is why Marx came up with this "law of the tendency of the rate of profit to fall" in the first place. He had already long before presented his basic explanation for the cause of capitalist overproduction crises—the fact that surplus value is extracted from the workers, i.e. that they are not (and cannot be) paid for the full value of all the commodities they produce for the capitalists; that therefore the workers cannot buy back all that they produce; and that therefore the main thing the capitalists can do with all this surplus (other

than their own luxurious consumption and *loaning* some of it back to the workers) is to further expand their productive capacity. In short, capitalism inevitably leads to the massive and ever-growing overproduction of real capital, along with ever-expanding credit bubbles to provide new markets for that expanding productive capital.

Marx also had his auxiliary theory, the anarchy of different capitals, to explain capitalist economic crises. So why did he need yet another law?

Sometimes people do try to come up with as many arguments as they can think of to support a proposition. Thomas Aquinas, for example, proposed five different arguments to prove that God exists. (See my philosophical doggerel about this at <http://www.massline.org/PhilosDog/A/Aquinas.htm>) Of course one proof, if it really was a "proof", would be quite enough! But Aquinas was smart enough to understand that none of the "proofs" he put forward were really incontrovertibly certain (even to his fellow theologians). So he appeared to think that 5 weak "proofs" would somehow prove what really only one solid proof could possibly accomplish.

In other cases people sometimes weaken their overall position by providing additional dubious arguments to try to back up their one really good argument. This allows their opponents to focus on and criticize the bad arguments and ignore the good one.

But the case of Marx and capitalist economic crises is quite different. We (if not the bourgeoisie) already know full well that these crises are inherent in capitalism. What needs to be given is *one* good and coherent overall explanation for why that is. Putting forward a lot of *different* and *unrelated* explanations for why crises occur actually goes against what needs to be done here, and against what Marx was trying to do. Marx was a brilliant man and I'm sure he understood this. In other words, he surely did not *see himself* as putting forward multiple different and conflicting crisis theories. (This is only how most of us Marxists following him have viewed things.)

Similarly, the frequently heard claim among Marxists that Marx was putting forward a *new* crisis theory (the tendency of the rate of profit to fall) *in place of* the old overproduction crisis theory he had already put forward in the same book makes no sense at all. If that was what he had been up to he would not have just added new chapters to an existing work, but rather changed the old chapters, or even have started totally over again.

So what then was he up to in those chapters on the falling rate of profit? Here's what I think was going on: Marx was trying to explore and explicate every aspect of capitalist production, how it worked, and all the contradictions inherent in it. Moreover, he had started very early on (in the 1840s) with the basic premise that only living human labor could create surplus value. In thinking about that, and all its implications, it occurred to him that this would have to mean that as more and more machinery was employed in production (as he saw in industry all around him), the expense of machinery would grow ever more proportionally larger, while the expense for labor power would inevitably become proportionally less of the costs of production. But, his basic assumption was that only this ever-diminishing portion of the whole outlay could create surplus value and profits. And thus it was at least implicit in his assumptions that profits had to

fall over time.

In other words, this whole business of the growing organic composition of capital over time was a real puzzle for Marx's conception, a real difficulty that he was forced to address (because he was intellectually honest). He *had to admit* that on his own theory the rate of profit should fall (and keep falling overall) over time. But he could plainly see that this was not always the case in the real world, and that therefore there had to be some major countervailing factors to figure out and explain.

What I am suggesting here is that it was not really Marx's motivation at all to come up with a new central explanation for why crises occurred, a new theory to replace his existing crisis theory (or theories!). On the other hand, if the rate of profit was tending to fall over time, that clearly did have to be incorporated into his crisis theory; that really did have to be a part of the overall explanation for crises.

This was the situation with his theory that Marx found himself in. And *given his fundamental assumption* that *only* living labor in the current production process could create surplus value, there was really no other course for him but the one he followed, with regard to trying to both explain—and to explain away—the tendency of the rate of profit to fall.

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However, in my view that initial assumption is just plain wrong. The central proposition of the labor theory of value is absolutely correct; all value (at least so far on this planet) does ultimately come from human labor acting on the natural products of the world around us, but *past* labor which is again used in the current production process must count just as much as *current* labor (including that which went into the production of the machines being used again).

All production involves not only "current" labor, but also past labor—since what a worker did a few seconds ago is already in the past. Suppose one worker builds a machine, and then uses that machine to make some commodity for sale. Should we only count the labor the worker uses in running the machine (and not also that expended in building the machine) when we calculate the labor-time and surplus value that is ultimately extracted?

And suppose the worker then uses the machine to make a second, and a third commodity. Isn't his or her labor that went into building the machine just as important in those cases too? All the machine is allowing the worker to do is to keep reusing the labor that went into making the machine in the first place. And it doesn't matter a bit if it is a different worker, or even a different worker in a different company, who built the machine. Whoever uses the machine is in a very clear and obvious sense reusing the labor of whoever built the machine.

The correctly apportioned socially-necessary labor time of *all* the labor that went into the production of any commodity is the source of all the value in that commodity. Some of it comes from the last steps the last worker did on the commodity, some of it comes from previous labor by the same or different workers. It incorporates the full value of all the raw materials (because this reflects the labor put into the raw materials by previous workers). But raw materials are used up in the production process and cannot be used again. And it incorporates the apportioned reuse

of any labor that went into the production of the machinery used along the way.

That, at least, is my theory. I haven't been able to convince anybody of it yet (except maybe a couple distant college students). But just suppose, for the moment that this theory is true. If it is true, then there is no reason to believe that any more-or-less steadily rising "organic composition" of capital is going to lead to any more-or-less steadily falling rates of profits in the first place! And in that case, the empirical evidence which pretty much demonstrates that there is no such thing as a long-term or overall tendency for the rate of profit to fall is no problem whatsoever for our theory of capitalist production and the reasons for its crises.

We simply go back to what Marx said in the first place: Crises are due to the extraction of surplus value which inevitably results in the overproduction of capital over time, along with credit bubbles that must eventually pop. Profits will fall, at least at points in the development of any crisis, but this is a *result* of the deeper contradictions, and not itself the underlying cause of the crisis.

There are other advantages to the theory I'm defending, including the resolution (or at least partial resolution) of many puzzles going under the name of the "transformation problem". But I won't get into that here.

If anybody is interested in further elaborations of this theory, see the articles and letters I have posted in the Labor Theory of Value section at <http://www.massline.org/PolitEcon/index.htm>

Criticisms of the ideas I've put forward here are always welcome!

Scott